



## Effectual tax audit and investigation paradigm: Probable panacea to tax hemorrhage in Nigeria

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### Abstract

This study empirically investigates the impact of tax audit and investigation in the detection and prevention of tax fraud in Nigeria. A structured questionnaire was adopted as instrument for data collection to elicit useful information from respondents. The cross-sectional survey research design was employed and stratified simple random sampling was adopted in selecting a sample size of 166 which consists of staff members of the Federal Inland Revenue Service, State Internal Revenue Service, Revenue Committees of the Local Government, tax consultants and the taxpaying public within Port Harcourt, Rivers State Nigeria. Pearson product moment correlation was used as a statistical tool for data analysis. Findings reveal that effective tax audit and investigations are reliable administrative tools that could be employed by the relevant tax authority to reduce and eradicate the rampant cases of tax fraud pervading every strata of the Nigerian society as it could help to boost tax revenue collection in the country. The study therefore recommends that tax audit and investigations unit should be constituted as a matter of priority by the relevant tax authority in all the tax offices. The unit should be decentralized and be empowered to perform its statutory roles of promoting voluntary but sincere tax compliance with the Nigerian tax legislation without any sort of compromise and red tapism.

**Keywords:** Tax audit, Tax investigation, Tax hemorrhage, Tax fraud, Paradigm

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### 1. Introduction

The concept of tax and taxation are quite familiar to every society be it advanced or less advanced countries of the world as tax has always been a medium by which villages, communities, cities as well as nations generate revenue and materials to provide themselves with basic facilities such as bridges, access roads, security and other community developmental projects. Government will find it difficult to provide the needed infrastructures and social amenities if the rate of tax compliance by the taxpaying public is very low on one hand and where there are prevalence of high rate of tax fraud and evasion as the case in Nigeria on the other hand. The increasing issues of tax evasion has made the Nigerian government to lose billion of revenues that would have been generated and channeled towards infrastructural developments and social welfare of the people. This huge leakage in tax revenue as a result of tax fraud is what the researcher referred to as tax hemorrhage. Tax compliance level in Nigeria is very low when compared with other developing countries like South Africa, Brazil and India. On the scale of voluntary compliance, Nigeria ranks among the lowest among most African countries as tax obligations are discharged reluctantly and grumbling by the citizens. Bulk of non-compliance involves false reporting of the tax base (Franzoni, 1999) <sup>[7]</sup>.

It will not be wrong to say that the average Nigeria abhors tax payment. Resistance to imposition and payment of tax in the colonial era of British domination in Nigeria was as intensive as it was extensive, especially in Southern Nigeria cities of Aba, Warri, Calabar and others. There were reported cases of tax riots in Warri and Kwale in 1927 when poll tax assessment of two-and-half ( $2\frac{1}{2}$ ) of annual income was levied on the people.

The Aba women riot of 1929 in the Eastern Nigeria was because of their resentment over the imposition of taxes. The riot over tax imposition and payment reportedly spread to Opopo in the present day Rivers State and Calabar, Cross Rivers State where several people were reportedly killed and injured.

Tax fraud is a global issue that affects both the advanced and the less advanced countries of the world. However, less developed country like Nigeria tend to suffer the most pain because of the high propensity to evade tax coupled with weak enforcement by the relevant tax authorities. Tax fraud has resulted in tax hemorrhage as the Nigerian Government have been deprived of significant amount of revenue that would have been generated and deployed for massive capital formation leading to economic growth and sustainability. To stop this economic hemorrhage resulting from tax evasion and promote the culture of voluntary tax compliance, self-assessment scheme and the tax audit department were introduced. Of recent, voluntary assets declaration was introduced. According to Naiyeju (1996) <sup>[9]</sup>, the operation of self-assessment allows the taxpayer to determine his tax liability and account for tax collected. Under this scheme, the responsibility of taxation is substantially placed on chargeable persons or entities. Given the propensity of the average tax payers in Nigeria to evade tax payments, the relevant revenue service, must however, check the completeness and accuracy and the overall level of compliance of the tax payer with the provisions of the tax law. To enforce compliance and stop the prevalent tax hemorrhage through tax fraud, the department of Assessment, Intelligence, Tax Audit and Investigation was approved in 1993 to operate under the Federal Inland Revenue Service. As part of the tax reforms agenda of the Nigerian government, tax audit and investigations was considered as a powerful tool that can ensure compliance and that can be used to stimulate and guide its economic goal and social development. Tax audit is not supposed to be a punitive measure by the relevant authority, but an exercise to ensure that the amount due to the government has been correctly determined and collected (Naiyeju, 1996) <sup>[9]</sup>. For the audit work to achieve its objectives of enhancing voluntary compliance with the tax statutes and block tax revenue linkages through tax evasion, it is important to perform regular and thorough tax audit exercise. For the tax audit exercise to be successful, the audit team must be properly motivated and empowered. For effectiveness and efficiency, the audit team should be exposed to the use of information and computer technology (ICT) and have a good grasp of the audit environment. Besides, a functional tax appeal procedure should be instituted to check the excesses of both the tax audit staff and the taxpaying public. This research therefore is aimed at investigating the extent to which tax audit and investigations had assisted and could assist in voluntary compliance by taxpayers and in curbing revenue linkages emanating from tax fraud.

### 1.1. Research Objectives

The general objective of this study is to examine the role of tax audit and investigation in tax fraud detection and prevention in Nigeria. The specific objectives are to:

1. Find out whether the absence of a functional tax audit and investigation could lead to tax infraction in Nigeria.
2. Evaluate the influence of tax audit and investigation on voluntary tax compliance by Nigerian taxpayers.

3. Ascertain whether tax audit and investigation are viable and reliable tools for tax fraud detection in Nigeria.
4. Investigate whether tax audit and investigation are viable and reliable tools for tax crime prevention in Nigeria.
5. Find out whether tax audit and investigation could be employed to curb tax revenue linkages in Nigeria.

### 1.2. Research Questions

1. To what extent would the absence of tax audit and investigations lead to tax fraud in Nigeria?
2. To what extent could tax audit and investigations influence voluntary tax compliance of taxpayers in Nigeria?
3. To what extent could tax audit and investigations be used as a viable tool for fraud detection and maximum tax collection machinery in Nigeria?
4. To what extent could tax audit and investigations be used as a viable tool for tax crime prevention in Nigeria?
5. To what extent could tax audit and investigation be employed to curb tax revenue linkages in Nigeria?

### 1.3. Statement of Research Hypotheses

To meet the stated objectives, the following research hypotheses stated in null form becomes imperative:

- H01:** There is no significant relationship between functional tax audit and investigation and the minimization of tax fraud in Nigeria.
- H02:** There is no significant relationship between tax audit and investigation and voluntary tax compliance in Nigerian.
- H03:** There is no significant relationship between tax audit and investigation and tax fraud detection in Nigeria.
- H04:** There is no significant relationship between tax audit and investigation and tax crime prevention in Nigeria.
- H05:** There is no significant relationship between tax audit and investigation and tax revenue linkages in Nigeria.

## 2. Literature Review

### 2.1. Tax Audit and Investigation as a tool for Enforcing Compliance and Blocking Tax Linkages

Tax audit is a routine examination of the tax returns, accounts, books, records, documents, etc of a taxpayer by the tax authority in order to ascertain the level of compliance with the relevant tax laws (Bassey, 2013) <sup>[4]</sup>. Tax investigations may be carried out where the tax authority has a strong suspicion of the existence of tax fraud. Tax audit and investigations is a department set up to seek and ensure the implementation of tax laws fairly, faithfully, firmly and equitably, irrespective of the status of the persons and organizations concerned or the nature of goods and services involved (Naiyeju, 1996) <sup>[9]</sup>. The key duties of every revenue service both in the developed and developing countries include tax assessment and collection of taxes assessed. Taxes assessed and not collected or collected but not properly accounted for and utilized amount to a disservice to the people and the government. It amounts to waste of resources as time and energy may have been dissipated. Therefore tax audit and investigations plays a key role in the collection machinery as it supports the collection unit of the revenue service to achieve maximum revenue collection of all tax assessments as well as bringing some level of sanity and voluntary compliance to the tax environment. According to Osirim (2016) <sup>[13]</sup>, tax audit is aimed at determining whether the tax computation submitted by the tax payer to tax officials

are in agreement with the supporting records and to ensure all applicable tax laws have been complied with. Noncompliance with the provisions of the tax statutes and other statutory regulations is a potential case for litigation in the court of law. According to Dike (2000) <sup>[6]</sup>, the principal objective of tax audit is to collect the maximum revenue and the minimization of interference with legitimate trade.

### 2.1.1 Legal Framework for Tax Audit and Investigation

The Federal Tax Authority in Nigeria commonly called The Federal Inland Revenue Service is empowered by various provisions of the tax legislation to perform tax audit and investigation. Some of the relevant sections of the tax Acts as noted by Bassey (2013) <sup>[4]</sup> are Section 29 (1) of the FIRS (Establishment) Act, 2007; Section 35 of the FIRS (Establishment) Act, 2007 and Section 60 (4) of the Companies Income Tax Act, Cap 21, LFN 2004 as amended by Section 17 of the Companies Income Tax (Amendment) Act, 2007, which states that:

“Nothing in this section or in any other provision of this Act shall be construed as precluding the Service from verifying by tax audit or investigation into any matter relating to any return or entry in any book, document, accounts, including those stored in a computer, digital or magnetic, optical or electronic media as may, from time to time, be specified in any guideline by the Service”.

Section 29 (1) of the FIRS (Establishment) Act, 2007 states: “Notwithstanding anything to the contrary in any other enactment or law, an authorized officer of the Service shall at all reasonable times have free access to all lands, buildings, places, books and documents, in the custody or under the control of a public officer, institution or any other person, for the purpose of inspecting the books or documents including those stored or maintained in computers or on digital, magnetic, optical or electronic media, and any property, process or matter which the office considers necessary or relevant for the purpose of collecting any tax under any of the relevant enactment or law or for the purpose of carrying out any other function lawfully conferred on the Service or considered likely to provide any information required for the purposes of any of those enactments or any of those functions and may, without fee or reward, make extract from, or copies of, such books or documents”.

Section 35 of the FIRS (Establishment) Act, 2007 states: “The Service shall employ Special Purpose Tax Officers to assist any relevant law enforcement agency in the investigation of any offence under this Act (subsection 1). Notwithstanding anything to the contrary in any other enactment or law, the Service shall have the power to investigate or cause investigation to be conducted to ascertain any violation of any tax law whether or not such violation has been reported to the Service (subsection 2). In conducting any investigation under subsection (2) of this section, the Service may cause investigation to be conducted into the properties of any taxable person if it appears to the Service that the lifestyle of the person and extent of the properties are not justified by his source of income (subsection 3). Where any investigation under this section reveals the commission of any offence or an attempt to commit any offence, the Service shall, pursuant to section 48 of this Act, undertake the prosecution of the offences (subsection 4)”.

### 2.1.2 Methodology of Tax Audit and Investigations

Tax audit and investigation are not to be performed haphazardly but in a methodical or systematic manner. First, it involves the **selection of taxpayers for audit and investigation**: It is a herculean task for the Federal Inland Revenue Service or the Area Tax Office to perform tax audit in all the companies in Nigeria within a year, therefore the Area Tax Office or the audit management may randomly select without using any parameters companies to be audited. Besides none or wrong filling of tax returns or suspicion of the existence of tax fraud may trigger off a tax audit and investigations. A claim for tax refund and information of non-compliance from the intelligence unit or other regulatory agencies can be used as criteria for selecting taxpayers for audit and investigations (Osirim, 2016) <sup>[13]</sup>.

**Second, it involves a background research**: After the selection of taxpayers for field audit, the tax audit team should gather relevant information about the taxpayer to be audited. This could be done by reviewing and extracting information from the taxpayer file as regards the name of taxpayers, tax file or tax identification number (TIN), name and nature of business with address, incorporation status (C of I) and date of commencement of business, corporate structure, the size of the business and its complexity.

**Third, involves tax audit planning**: Having carried out a background research on the company, the next stage is the preparation of audit plan. Before the audit exercise is actually performed, there must be adequate audit planning, which entails the development of appropriate strategies and the preparation of audit checklist to help in the achievement of the audit objectives. The outline of audit assignment to be performed, the number of qualified staff to perform the job and the budgeted time and cost of the audit must be well articulated at the planning stage. This will facilitate a seamless audit and investigations exercise.

**Finally, involves notification and accounts examination**: Once the planning has been done, the next stage is to inform the company about the proposed date for the tax audit and the scope of the exercise and documents that are to be made available for a seamless audit exercise. Once the cooperation and understanding of the company have been solicited, the actual field audit will be undertaken. Having acquitted himself with the background information of the company, the audit team will move to examine the financial statements of the company and other corroborative evidence/documents such as minutes of board meetings, tax returns, third parties confirmations etc to obtain facts and audit evidence that will form the basis of the tax audit report and recommendations (Osirim, 2016) <sup>[13]</sup>.

### 2.2 Theoretical Review

This paper is anchored on the theory of reasoned action (TRA). The theory predicts the attitudinal disposition of humans which is connected to the norms and surrounding of such a person. Subjective norm is defined as individual's perception of what should or should not be done. Therefore, the theory is of the view that when people form an intention to act then they will be free to act. In practice however, environmental bottlenecks will limit the freedom of people to act in certain way. This theory is relevant to this study because it explains the association between the tax payers and the revenue officials.

### 2.3 Empirical Review

Generally speaking, a holistic audit and investigation exercise with impositions of sanctions on tax evaders will largely stop the tax hemorrhage prevalent in the Nigerian tax space. According to Massimo (2003) <sup>[8]</sup>, individuals normally would like to evade their tax liabilities entirely and the only reason they might not do so is that there is some non-zero probability of being caught. This means that taxable persons will be more willing to pay the actual tax liabilities if there is a high probability of detection of noncompliance and imposition of heavy sanctions. Therefore, raising the probability of detection will result to tax compliance and tax audit represents one of the effective detectives' measures used by tax authorities. Witte and Woodbury (1985) <sup>[16]</sup>, find a significant positive relationship between the risk of tax audit and the rate of voluntary compliance. However the study by Beron *et al* (1990) <sup>[5]</sup> shows that tax audit have only a modest positive impact on tax compliance. The findings of Owojori (2006) <sup>[14]</sup> on the topic "Towards Improving Tax Audit and Investigations in Nigeria" reveal that strengthening of tax audit and investigation units would wipe away tax evasion.

Olaoye and Ekundayo (2019) <sup>[10]</sup> investigated the effects of tax audit on tax compliance and remittance of tax revenue in Ekiti State using desk, field, back duty and remittance audits

as proxies for tax audits. Correlation matrix and multiple regression were adopted in the analysis of data. Findings indicate that there is a positive and significant relationship between the variables. Thus recommending that Ekiti State Government should intensify tax audit through the employment of more competent personnel and intermittent training should be given to them in order to cause increase in tax compliance level in the State. Their findings are similar to that of Onuoha and Dada (2016) <sup>[12]</sup> who concluded that tax audit has significant effects on revenue and that tax audit and investigations are inevitable to improve on the collection of tax revenues in Nigeria.

### 3. Methodology

The geographical area of study is Rivers State, South-South geo-political zone of Nigeria. The study employed the cross-sectional survey research design as it permits questionnaire to be used in gathering relevant data on all the variables of study. The data was gathered through a field survey from various tax stakeholders using liker-type structured questionnaire which was subjected to face and content validity and the items on the questionnaire were considered appropriate for the study. The population of the study is made up of all relevant stakeholders of tax administration in Rivers State, which consists of:

**Table 1:** Field survey from various tax stakeholders

Stakeholders	Population (P)	Percentage (%)
Staffers of Federal Inland Revenue Service	210	25
Staffers of State Internal Revenue Service	180	22
Staffers of Local Government Revenue Committee	50	6
Tax Consultants	40	5
Taxpayers (both in the public and in the private)	350	42
<b>Total</b>	<b>830</b>	<b>100</b>

The stratified simple random was adopted in selecting a sample size of 166, which consists of:

**Table 2:** Data was gathered through a field

Stakeholders	Population (P)	Percentage (%)
Staffers of Federal Inland Revenue Service	42	25
Staffers of State Internal Revenue Service	36	22
Staffers of Local Government Revenue Committee	10	6
Tax Consultants	8	5
Taxpayers (both in the public and in the private)	70	42
<b>Total</b>	<b>166</b>	<b>100</b>

### 4. Empirical Outcomes

**Table 3:** Summary of the correlation between tax audit/investigation and tax fraud

	Tax audit & investigations	Tax fraud	Narration
Pearson Correlation	1	0.621	62%
Sig. P (2 tailed)		0.000	0.000 < 0.05
N	166	166	

Findings from table 4.1 above reveals that tax audit and investigations had a significant positive relationship with tax fraud as  $r = 0.621$  and  $p\text{-value} < 0.05$ . Therefore hypothesis

one which states that there is no significant relationship between functional tax audit and investigation and the minimization of tax fraud in Nigeria is rejected.

**Table 4:** Summary of the correlation between tax audit/investigations and voluntary tax compliance

	Tax audit & investigations	Voluntary Compliance	Narration
Pearson Correlation	1	0.484	48%
Sig. P (2 tailed)		0.000	0.000 < 0.05
N	16	166	

Findings from table 4.2 above reveals that tax audit and investigations have a significant low positive relationship with voluntary tax compliance as  $r = 0.484$  and  $p\text{-value} < 0.05$ .

Therefore hypothesis two which states that there is no significant relationship between tax audit and investigation and voluntary tax compliance in Nigerian is rejected.

**Table 5:** Summary of the correlation between tax audit/investigations and tax fraud detection

	Tax audit & investigations	Tax fraud prevention/detection	Narration
Pearson Correlation	1	0.681	68%
Sig. P (2 tailed)		0.001	0.001 < 0.05
N	166	166	

Findings from Table 4.3 above reveals that tax audit and investigations has a significant positive relationship with tax fraud detection as  $r = 0.681$  (68%) and  $p\text{-value}$  of 0.001 is less than 0.05 (5%) level of significance. Therefore,

hypothesis three, which states that there is no significant relationship between tax audit and investigation and tax fraud detection in Nigeria is not accepted.

**Table 6:** Summary of the correlation between tax audit/investigations and tax crime prevention

	Tax audit & investigations	Tax fraud prevention/detection	Narration
Pearson Correlation	1	0.617	62%
Sig. P (2 tailed)		0.001	0.001 < 0.05
N	166	166	

Findings from Table 4.3 above reveals that tax audit and investigations has a significant positive relationship with tax fraud detection as  $r = 0.617$  (62%) and  $p\text{-value}$  of 0.001 is less than 0.05 (5%) level of significance. Therefore,

hypothesis three, which states that there is no significant relationship between tax audit and investigation and tax fraud detection in Nigeria is not accepted.

**Table 7:** Summary of the correlation between tax audit/investigations and tax revenue linkages

	Tax audit & Investigations	Revenue linkages	Narration
Pearson Correlation	1	0.754	75%
Sig. P (2 tailed)		0.001	0.000 < 0.05
N	166	166	

Findings from Table 4.5 above shows that tax audit and investigations could be relied upon in curbing tax revenues linkages in Nigeria as  $r = 0.754$  and  $p\text{-value} < 0.05$ . Therefore hypothesis four which states that there is no significant relationship between tax audit and investigation and tax revenue linkages in Nigeria is not supported and thus rejected.

#### 4.1 Discussion of Findings

The findings of the research in Table 4.1, 4.3 and 4.4 reveal that tax audit and investigations could be employed as a reliable tool to detect and reduce the cases of tax fraud, and to prevent their occurrence in Nigeria. On the average, it can be ascertained that tax audit and investigations is a principal administrative instrument that can be employed in the detection and prevention of tax infraction. In table 4.2, the research findings show that tax audit and investigation had a significant low positive relationship with voluntary tax compliance. This implies that uncompromising and effective tax audit and investigations could motivate taxpayers to comply with the provisions of the tax law and to file their tax returns voluntarily and timely for fear of being audited or investigated and penalized for any tax infractions noticed in the course of the audit exercise. Lastly, table 4.5 indicates that tax audit and investigations could be relied upon to a large extent in curbing tax revenues linkages in Nigeria as  $r = 0.754$  and  $p\text{-value}$  is significant at 5% ( $0.000 < 0.05$ ).

The findings from the data analyzed are quite revealing and correlated largely with the views of other researchers. The findings agree with Owojori (2006) [14] who states that strengthening of tax audit and investigation units would wipe

away tax evasion and the non-establishment and fortification of tax audit and investigation can bring more tax evasion. Shares a similar view that tax audits are considered to have both direct deterrent effect on the taxpayers actually audited and indirect deterrent effect on the taxpayers not audited. The results of the study also give credence to the conclusion of Olaoye and Ekundayo (2019) [10] who concluded that tax audit will engender tax compliance and remittance in Ekiti State. Even, Onuoha and Dada (2016) [12] concluded that tax audit and investigation are inevitable to improve on the collection of tax revenues in Nigeria while Adediran, Alade and Oshode (2013) [1] submitted that tax audit and investigations could increase the revenue base of the government and can wipe out incidents of tax evasion in the country. The corollary of these research outcomes is that effective tax audit and investigation could improve compliance level and curb excessive linkages in the system.

#### 5. Conclusion and Recommendations

This study has revealed the relevance of tax audit and investigations in mitigating tax infractions and boosting tax revenue in Nigeria. Tax audit and investigation is a reliable tool for combating tax fraud based on the findings obtained from the field work in this study. Based on the result of the tested hypothesis, it is abundantly clear that the creation of a functional tax audit and investigation unit under Federal Inland Revenue service (FIRS) and other States Internal Revenue Service directorate will significantly minimize the rate of tax fraud in Nigeria and non-establishment and weak performance of the unit will create room for tax fraud, and depletion in the revenue generation capacity of the

government. Based on the findings the following important recommendations are made:

- Tax audit and investigation unit should be constituted as a matter of priority and urgency by relevant tax authority in all the tax offices. The unit should be decentralized and be empowered to perform its statutory roles of promoting voluntary but sincere tax compliance within the environment of the Nigerian tax legislation without undue influence or compromise.
- Qualified accountants and tax practitioners/administrators with requisite knowledge of information communication technology (ICT) and machine learning should be engaged to perform the tax audit and investigations exercise.
- Adequate tax education and enlightenment should be undertaken by the relevant revenue agencies on the importance of tax payments and the disadvantages of shortchanging the government in the area of tax payment.

### 6. Limitations of the Study

Besides tax audit and investigations, it was noted in the course of the research work that tax compliance could also be improved through proper education of tax payers and judicious use of tax revenue by public authority. The major limitation faced in the course of this study was the reluctance and withdrawal of some respondents to be involved in the study due to their busy schedule. However, the researchers were able to manage this situation by including other willing respondents.

**Conflict of Interest:** The authors declare that there is no conflict of interest regarding the publication of this work.

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